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## NOTE

### A “Holding Company Exception” to *Hertz*?

3123 SMB LLC v. Horn, 880 F.3d 461 (9th Cir. 2018)

Lauren Vincent\*

#### I. INTRODUCTION

Diversity jurisdiction, as defined in 28 U.S.C. § 1332, requires that all persons on one side of a controversy be citizens of different states than all persons on the other side.<sup>1</sup> Specifically, § 1332(c) provides that a corporation is “a citizen of every State . . . by which it has been incorporated and of the State . . . where it has its principal place of business.”<sup>2</sup> Defining the phrase “principal place of business,” however, has proven challenging for the federal courts.<sup>3</sup> As a result, for several decades, courts developed and applied a plethora of tests that muddled the question of corporate citizenship, yielding widespread inconsistent results.<sup>4</sup>

After the Supreme Court of the United States announced in *Hertz Corp. v. Friend*<sup>5</sup> that a corporation’s principal place of business is its “nerve center” – i.e., its “center of direction, control, and coordination” – the complexity associated with determining a corporation’s principal place of business seemed to be a thing of the past.<sup>6</sup> Although the *Hertz* decision brought substantial clarity to the issue of corporate diversity jurisdiction, its one-size-fits-all test for determining principal place of business has proven less than straightforward when applied to modern corporate structures – notably, holding companies. This Note addresses one perplexing problem that *Hertz*’s “nerve center” test failed to anticipate: How should courts determine the “principal place of business” of a corporation that is designed to engage in few, if any, substantial business activities, such as a holding corporation?

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1. 28 U.S.C. § 1332(a)(1) (2018); *Caterpillar Inc. v. Lewis*, 519 U.S. 61, 68 (1996); see also *infra* notes 59–69 and accompanying text (explaining subject matter jurisdiction).

2. 28 U.S.C. § 1332(c)(1).

3. See *infra* Section III.B.1.

4. See *infra* Section III.B.1.

5. 559 U.S. 77 (2010).

6. *Id.* at 93. Indeed, the *Hertz* decision extinguished all other preexisting tests for determining principal place of business. *Id.* at 96.

Although some attempts have been made to reconcile the unique nature of holding corporations with *Hertz*'s "nerve center" test, the federal courts have begun crafting rules of corporate citizenship that deviate from *Hertz* precedent and pronounce new rules for determining the principal place of business of holding companies.<sup>7</sup> The dangers of such deviation are perfectly showcased in the 2018 decision of *3123 SMB LLC v. Horn*,<sup>8</sup> where the Ninth Circuit held that a recently-formed holding corporation's principal place of business can be located where it simply *plans* to hold board meetings – regardless of whether any such meetings have occurred prior to the filing of a lawsuit.<sup>9</sup>

This Note argues the Ninth Circuit's approach to determining the corporate citizenship of a newly-formed holding corporation strays considerably from *Hertz* precedent, announces a "holding company exception" to *Hertz*,<sup>10</sup> and invites small business owners to invent diversity jurisdiction through the convenient creation of holding corporations just days before filing in federal court. This Note further argues that a newly-formed holding corporation's principal place of business must not be based on where its high level officers *intend* to direct, control, and coordinate its activities at a future date but must instead be based on where its high-level officers are *actually* directing, controlling, and coordinating its activities at the time a lawsuit is filed. Finally, this Note considers the ways in which the legislature and the courts can craft and interpret diversity jurisdiction rules to address the uniqueness of holding corporation structures while remaining true to the holding announced in *Hertz*.

## II. FACTS AND HOLDING

A limited liability company known as 3123 SMB LLC (the "LLC") filed a legal malpractice action against attorney Steven J. Horn ("Horn") (the "Lawsuit") in the U.S. District Court for the Central District of California after retaining Horn to represent it in an underlying property damage lawsuit.<sup>11</sup> Due to the complex nature of the facts in *3123 SMB, LLC v. Horn*, this Part proceeds chronologically in four Sections. First, Section A summarizes the underlying property damage lawsuit filed in California state court. Second, Section B describes the creation of the LLC and the subsequent termination of Horn's representation. Third, Section C articulates the formation of Lincoln One Corpo-

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7. See, e.g., *3123 SMB LLC v. Horn*, 880 F.3d 461 (9th Cir. 2018).

8. *Id.*

9. *Id.* at 471.

10. Despite the fact that in *Johnson v. SmithKline Beecham Corp.* the Eastern District of Pennsylvania stated, "[T]here is no indication that the *Hertz* Court intended to create a 'holding company exception' to its admonition that a corporation has only one nerve center," this Note argues that this is precisely what the Third Circuit did in affirming the Eastern District's judgment on appeal. 853 F. Supp. 2d 487, 495 (E.D. Pa. 2012), *aff'd*, 724 F.3d 337 (3d Cir. 2013) (citation omitted). Further, this Note argues that this is what the Ninth Circuit did in its decision of *3123 SMB LLC*.

11. *Id.* at 463–64.

ration (the “Corporation”) – a holding corporation. Lastly, Section D concludes this Part with a summary of the legal malpractice lawsuit that is the subject of the diversity jurisdiction issue presented in the *3123 SMB, LLC v. Horn*.

### A. The Underlying Property Damage Lawsuit

In July of 2008, Anthony Kling and his mother, Mary Kling, brought suit against multiple defendants,<sup>12</sup> claiming a nearby construction project was responsible for causing subsidence damage to an apartment building they owned in Santa Monica, California.<sup>13</sup> The Klings retained Horn, a California attorney, to represent them in the dispute and filed their complaint in Los Angeles Superior Court.<sup>14</sup>

### B. The Creation of 3123 SMB LLC and Horn’s Termination

In July of 2011, three years after the original filing of their property suit, the Klings organized the LLC<sup>15</sup> in Missouri and listed its place of business as Clayton, Missouri.<sup>16</sup> The Klings resided in California, but they claimed to have family and business connections in Missouri.<sup>17</sup> The Klings transferred their ownership of the Santa Monica property to the LLC.<sup>18</sup> The LLC’s sole business activity was to manage the lawsuits that arose over the destruction of the Santa Monica property, and the Klings were the only persons authorized to act on the LLC’s behalf.<sup>19</sup>

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12. *Id.* at 464 (citing *Kling v. Hassid*, No. B261391, 2016 WL 538238, at \*1 n.2 (Cal. Ct. App. Feb. 10, 2016). The named defendants were “Joseph Hassid, Santa Monica Investments, LLC, and Bay Cities Discount Kitchen and Appliances, Inc.” *Kling v. Hassid*, No. B261391, 2016 WL 538238, at \*1 n.2 (Cal. Ct. App. Feb. 10, 2016). “In October 2008, [the Klings] amended their complaint to name Gabai [Construction, LLC,] as a defendant.” *Kling v. Gabai Constr.*, No. B235367, 2012 WL 5458924, at \*1 (Cal. Ct. App. Nov. 9, 2012).

13. *3123 SMB LLC*, 880 F.3d at 463; *see also Gabai*, 2012 WL 5458924, at \*1.

14. *3123 SMB LLC*, 880 F.3d at 463.

15. “A limited liability company (LLC) is a hybrid business entity that offers its members limited liability as if they were shareholders of a corporation[] but treats the entity and its members as a partnership for tax purposes.” Ann. K Wooster, Annotation, *Construction and Application of Limited Liability Company Acts – Issues Relation to Formation of Limited Liability Company and Addition or Disassociation of Members Thereto*, 43 A.L.R. 6th 611, West (database updated weekly).

16. *3123 SMB LLC*, 880 F.3d at 464.

17. *Id.*

18. *Id.* In May 2013, the Klings amended their original complaint in the property damage lawsuit and added the LLC as a new party plaintiff in all remaining state court litigation. *Id.*

19. *Id.*

In October of 2013, the LLC terminated Horn's representation after Horn failed to comply with certain California local court rules.<sup>20</sup> As a result of Horn's errors, the trial court dismissed the LLC's case with prejudice for failure to bring the action to trial within five years – which is a violation of California Code of Civil Procedure section 583.310.<sup>21</sup>

### *C. The Incorporation of Lincoln One*

In September of 2014, roughly one year after the LLC terminated Horn's representation, Mary Kling organized the Corporation.<sup>22</sup> The Corporation's Missouri attorney filed the necessary articles of incorporation and listed his office in Clayton, Missouri, as Mary Kling's address.<sup>23</sup> Shortly after its incorporation, the Corporation became the sole member of the LLC.<sup>24</sup> Mary Kling served as the Corporation's president, secretary, and only high-level officer; Anthony Kling served as a board member.<sup>25</sup> The Corporation's sole business was "to provide direction to [the LLC]," which included prosecution of the lawsuits concerning the damage done to the Klings' Santa Monica property.<sup>26</sup> The Corporation's articles of incorporation specified that its board meetings would occur in Clayton, Missouri.<sup>27</sup>

### *D. The Legal Malpractice Lawsuit: 3123 SMB LLC v. Horn*

Twenty-five days after the Corporation's incorporation, the LLC filed the Lawsuit.<sup>28</sup> The LLC's complaint alleged the Central District of California had subject matter jurisdiction to hear its case because the parties were of diverse

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20. *Id.*; see Kling v. Hassid, No. B261391, 2016 WL 538238, at \*1 (Cal. Ct. App. Feb. 10, 2016). According to the LLC, certain exhibits proffered by Horn for a "Long Cause Binder," required by California law, were "incomplete, inadequate, and did not allow the case to be properly prepared for trial." 3123 SMB LLC, 880 F.3d at 463–64.

21. 3123 SMB LLC, 880 F.3d at 464; see Hassid, 2016 WL 538238, at \*1; see also CAL. CIV. PROC. CODE § 583.310 (West 2018).

22. 3123 SMB LLC, 880 F.3d at 464. Under California law, legal malpractice claims must be brought within one year of their discovery to fall within the proper statute of limitations. See CAL. CIV. PROC. CODE § 340.6(a) (West 2018); see also Lee v. Hanley, 354 P.3d 334, 336–37 (Cal. 2015).

23. 3123 SMB LLC, 880 F.3d at 464. All of Lincoln One's corporate records were kept in the Missouri attorney's Clayton office. *Id.* at 465.

24. *Id.* at 464.

25. *Id.* Anthony Kling owns seventy-five percent of the Corporation's shares, and Mary Kling owns the remaining twenty-five percent. *Id.*

26. *Id.* at 465.

27. *Id.* at 473; see also MO. REV. STAT. § 351.225.1(1) (2016); MODEL BUS. CORP. ACT § 7.01(b) (ABA 2016) (providing that a corporation's "principal office" as designated in its annual report is its location of annual meetings if not otherwise specified); cf., e.g., CAL. CORP. CODE § 600(a) (West 2018); N.Y. BUS. CORP. L. § 602(a) (McKinney 2017).

28. 3123 SMB LLC, 880 F.3d at 465; see *id.* at 467.

citizenship.<sup>29</sup> According to the LLC, Horn was properly a citizen of California and the LLC was properly a citizen of Missouri because its sole member at the time the Lawsuit was filed – the Corporation – was properly a citizen of Missouri.<sup>30</sup>

The Corporation did not engage in any “fundamental daily real estate business operations” when the LLC filed the Lawsuit.<sup>31</sup> Indeed, the Corporation’s only conceded business operation was to hold an annual meeting in Clayton, Missouri, at which it planned to approve directors and officers, modify bylaws, and issue stock.<sup>32</sup> Although the Corporation’s annual board meetings were described as taking place annually, no such meetings had been held at the time the Lawsuit was filed.<sup>33</sup> Neither Anthony nor Mary Kling visited Missouri between the date of the Corporation’s incorporation and the filing of the Lawsuit.<sup>34</sup> In October of 2015, *subsequent* to the filing of the Lawsuit, the Corporation held one board meeting in Clayton, Missouri.<sup>35</sup>

Horn moved to dismiss the Lawsuit for lack of subject matter jurisdiction, arguing that, under the “nerve center” test set forth by the Supreme Court of the United States in *Hertz Corp v. Friend*, the Corporation was properly a citizen of California.<sup>36</sup> In so arguing, Horn relied on the following language of the Court from *Hertz*:

[I]f the alleged ‘nerve center’ [of a corporation] is nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat, the court should instead take as the true ‘nerve center’ the place of actual direction, control, and coordination . . . .<sup>37</sup>

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29. Complaint ¶¶ 2–3, *3123 SMB LLC*, 880 F.3d 461 (2:14-cv-08115); *see also* 28 U.S.C. § 1332(a) (2018) (“The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$75,000 . . . and is between . . . citizens of different States.”).

30. Appellant’s Brief at 6, *3123 SMB LLC*, 880 F.3d 461 (No. 16-55304), 2016 WL 4208228, at \*6; *see also* *GMAC Commercial Credit LLC v. Dillard Dep’t Stores, Inc.*, 357 F.3d 827, 829 (8th Cir. 2004) (“[A]n LLC’s citizenship is that of its members for diversity jurisdiction purposes . . . .”); *Cosgrove v. Bartolotta*, 150 F.3d 729, 731 (7th Cir. 1998). *See generally* *Carden v. Arkoma Assocs.*, 494 U.S. 185 (1990) (concluding that, unless Congress otherwise provides, members of an LLC are citizens for diversity purposes).

31. *3123 SMB LLC*, 880 F.3d at 465.

32. *Id.*

33. Defendant-Appellee Steven Horn’s Answering Brief at 2, *3123 SMB LLC*, 880 F.3d 461 (No. 16-55304), 2016 WL 5929180, at 2 [hereinafter Horn’s Answering Brief] (“[T]he only evidence of any [Corporation] activity is Missouri is a single board meeting that occurred well after this case was filed . . . .”).

34. *3123 SMB LLC*, 880 F.3d at 467; *see also* Horn’s Answering Brief, *supra* note 33, at 7, 20.

35. *3123 SMB LLC*, 880 F.3d at 464.

36. *See* Horn’s Answering Brief, *supra* note 33, at 29–30.

37. *Id.* at 14 (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 92–93 (2010)).

On this foundation, Horn argued the Corporation's incorporation in Missouri and intent to hold board meetings in Clayton, Missouri, sometime in the future was not enough to establish its corporate nerve center in Missouri.<sup>38</sup> According to Horn, the LLC's principal place of business for purposes of diversity jurisdiction must have been California because the LLC provided no evidence that Mary Kling directed its activity from Missouri or anywhere besides California.<sup>39</sup> Therefore, because Horn was also a citizen of California, Horn argued the case was not between diverse parties and could not be heard in federal district court pursuant to the diversity jurisdiction requirements set forth in § 1332.<sup>40</sup>

The LLC opposed Horn's motion to dismiss the Lawsuit.<sup>41</sup> Because the Corporation's sole business purpose was managing lawsuits, the LLC argued that the Corporation's activities "took place in conjunction with its outside counsel due to the narrow nature of its activities."<sup>42</sup> Put another way, the LLC argued that because its attorney is a citizen of Missouri, it, too, should be considered a citizen of Missouri.

The Central District of California agreed with Horn and dismissed the Lawsuit for lack of subject matter jurisdiction,<sup>43</sup> concluding that California rather than Missouri was the Corporation's principal place of business under *Hertz's* "nerve test."<sup>44</sup> The court found that there was "no evidence that any of the operations of [the Corporation] are directed, controlled, or coordinated from Missouri or anywhere else other than California[;]" that Mary Kling – the only officer of the Corporation – was a resident of California and did not travel to Missouri with regularity; that the LLC's attempt to rely on corporate documentation to establish the Corporation's principal place of business was, without more, insufficient proof that the Corporation's nerve center was in Missouri; and that it was "completely implausible" that the Corporation had not taken any actions in the twenty-five days of its existence.<sup>45</sup>

The court also rejected the LLC's argument that because the Corporation's sole business purpose is managing lawsuits, the location of its outside attorney should definitively establish its principal place of business for diversity purposes.<sup>46</sup> Relying on the nerve test adopted by the Court in *Hertz*, the Central District of California reiterated that the actions of the Corporation's "high level officers" control the principal place of business analysis rather than

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38. *Id.* at 22.

39. *Id.* at 20.

40. *See id.* at 30–31.

41. *Id.* at 7.

42. Appellant's Brief, *supra* note 30, at 13.

43. 3123 SMB LLC v. Horn, No. CV 14–8115 DSF, 2016 WL 2594625 (C.D. Cal. Feb. 16, 2016) (mem.).

44. 3123 SMB LLC v. Horn, No. CV 14–8115 DSF (FFMx), 2016 WL 6275168, at \*1 (C.D. Cal. 2016), *rev'd*, 880 F.3d 461 (9th Cir. 2018).

45. *Id.*

46. *Id.*

the location of outside persons the Corporation may hire.<sup>47</sup> The court concluded that the LLC had not established diversity jurisdiction and granted Horn’s motion to dismiss accordingly.<sup>48</sup> Notably, the court did not make any finding of jurisdictional manipulation.<sup>49</sup>

The LLC appealed to the U.S. Court of Appeals for the Ninth Circuit, arguing the Central District of California erred in dismissing its case for lack of subject matter jurisdiction because the parties were, in fact, diverse in citizenship.<sup>50</sup> The LLC reiterated its argument that under *Hertz*’s “nerve center” test, what very little business the Corporation did was done in Missouri and that, as a result, Missouri must be the location of the Corporation’s principal place of business.<sup>51</sup> Horn maintained that because the LLC failed to establish complete diversity existed with competent proof, the Central District of California’s decision to dismiss the Lawsuit for lack of subject matter jurisdiction was “manifestly correct.”<sup>52</sup>

The Ninth Circuit reversed the Central District of California’s jurisdictional dismissal, finding that the LLC presented competent evidence that the Corporation’s minimal activity was directed from board meetings in Missouri, even though no such board meetings had been held prior to the filing of the Lawsuit.<sup>53</sup> Therefore, the Ninth Circuit found that Missouri was indeed the Corporation’s – and, therefore, also the LLC’s – appropriate principal place of business for diversity jurisdiction purposes.<sup>54</sup> The Ninth Circuit stated that its reversal was conditional, however, and advised that the Central District of California was “free to consider whether there [wa]s jurisdictional manipulation or an alter ego relationship between [the Corporation] and [the LLC]” on remand.<sup>55</sup>

### III. LEGAL BACKGROUND

In *3123 SMB LLC*, the Ninth Circuit relied primarily on its own interpretation of *Hertz* to reach the decision that a holding corporation’s principal place of business is where it holds its board meetings, even if those meetings have yet to occur. First, as a means of placing the Ninth Circuit’s holding in context,

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47. *Id.*

48. *Id.*

49. *See id.*

50. Appellant’s Brief, *supra* note 30, at 6.

51. *Id.* at 8, 11.

52. Horn’s Answering Brief, *supra* note 33, at 30–31.

53. *3123 SMB LLC v. Horn*, 880 F.3d 461, 471 (9th Cir. 2018).

54. *Id.*

55. *Id.* The alter ego doctrine allows a court to “pierce the corporate veil” and toss aside the norms of “treat[ing] a corporation as an entity distinct from its shareholders” if there is evidence that the corporation exerts a heightened level of control over its subsidiary. Note, *Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853, 853–54 (1982); *see discussion infra* Section III.C.1.



this Part addresses the constitutional and statutory bases for federal jurisdiction. Second, this Part examines how corporations fit within that federal jurisdictional framework and discusses the *Hertz* decision, as well as its ramifications. Finally, this Part examines how a holding corporation's principal place of business has been determined in the post-*Hertz* era.

### *A. The Jurisdictional Framework in the Federal Courts*

Jurisdiction is a threshold question of whether a federal court has the power to hear a particular case or controversy.<sup>56</sup> It “depends upon the state of things at the time of the action brought.”<sup>57</sup> This means that a court cannot consider the location or status of the parties at any time beyond the date the pleadings are filed.<sup>58</sup>

While state courts have the power to hear all cases – except those that must be heard exclusively in other courts – and are considered courts of “general or universal jurisdiction,”<sup>59</sup> federal courts are courts of limited subject-matter jurisdiction.<sup>60</sup> Federal courts only have the power to hear cases that (1) fall within the limits of judicial power granted to them by Article III of the Constitution<sup>61</sup> and (2) have been assigned to them by a congressional jurisdictional grant of authority.<sup>62</sup>

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56. Dustin M. Dow, Note, *The Unambiguous Supremacy Clause*, 53 B.C. L. REV. 1009, 1017 (2012); see also *Davis v. Passman*, 442 U.S. 228, 239 n.18 (1979) (explaining the distinctions between jurisdiction, standing, and cause of action); *Marbury v. Madison*, 5 U.S. 137, 175 (1803).

57. *Grupo Dataflux v. Atlas Glob. Grp., L.P.*, 541 U.S. 567, 570 (2004) (citation omitted).

58. See *id.*

59. 12 MICHAEL D. MURRAY, MISSOURI PRACTICE SERIES: JURISDICTION, VENUE, LIMITATIONS § 8:381, West (database updated Aug. 2018). For example, the federal courts alone have jurisdiction over “cases in which the United States is a party,” “cases involving violations of the Constitution or federal law,” crimes on federal land, and bankruptcy cases. *Federal vs. State Courts – Key Differences*, FINDLAW, <https://litigation.findlaw.com/legal-system/federal-vs-state-courts-key-differences.html> (last visited Oct. 22, 2018).

60. 13 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE JURISPRUDENCE § 3522, West (database updated Sept. 2018).

61. U.S. CONST. art. III.

62. WRIGHT ET AL., *supra* note 60, § 3552.

The Constitution provides that the ‘judicial Power shall extend’ to ‘Controversies . . . between Citizens of different States’ . . . . Th[e] language [of Art. III, § 2] . . . does not automatically confer diversity jurisdiction upon the federal courts. Rather, it authorizes Congress to do so and, in doing so, to determine the scope of the federal courts’ jurisdiction within constitutional limits.

*Id.* (first alteration in original) (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 84 (2010)). Because the Constitution explicitly limits the power of the federal courts, Congress may

Jurisdiction is most commonly conferred on the federal courts through a party's invocation of federal question or diversity jurisdiction.<sup>63</sup> Federal question jurisdiction exists when the plaintiff's cause of action arises under federal law.<sup>64</sup> Diversity jurisdiction exists when a controversy involves citizens of different states and the amount in controversy exceeds \$75,000 – even if the plaintiff's cause of action arises solely under state law.<sup>65</sup> Diversity jurisdiction was primarily created to protect out-of-state defendants against local bias and prejudice.<sup>66</sup> To effectuate this purpose, complete diversity requires that the

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not extend the power it grants to federal district courts beyond the scope of Article III. *Kline v. Burke Constr. Co.*, 260 U.S. 226, 234 (1922).

63. See Michael G. Collins, *Jurisdictional Exceptionalism*, 93 VA. L. REV. 1829, 1854–55 (2007) (discussing that a federal court may also have jurisdiction in limited circumstances other than federal question and diversity cases, such as admiralty cases); see also 28 U.S.C. § 1331 (2018) (federal question jurisdiction); *id.* § 1332 (diversity jurisdiction).

64. U.S. CONST. art. III, § 2, cl. 1. (extending judicial power “to all cases, in law and equity, arising under . . . the laws of the United States.”); see also 28 U.S.C. § 1331 (“[D]istrict courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.”). Federal question jurisdiction is generally triggered when a “well-pleaded complaint establishes either that federal law creates the cause of action or that the plaintiff’s right to relief necessarily depends on resolution of a substantial question of federal law.” *Franchise Tax Bd. v. Constr. Laborers Vacation Tr. for S. Cal.*, 463 U.S. 1, 27–28 (1983); see also *Louisville & Nashville R.R. v. Mottley*, 211 U.S. 149, 153–54 (1908). However, federal question jurisdiction is beyond the scope of this Note and will not be discussed further.

65. 28 U.S.C. § 1332; see U.S. CONST. art. III, § 2, cl. 1 (extending judicial power “to Controversies . . . between Citizens of different States.”); see also Collins, *supra* note 63, at 1830–31. Diversity jurisdiction requires that the amount in controversy exceed \$75,000. 28 U.S.C. § 1332(a).

66. *Ho v. Ikon Office Sols., Inc.*, 143 F. Supp. 2d 1163, 1164 (N.D. Cal. 2001) (“The primary purpose of the diversity statute is to avoid prejudice against ‘outsiders’ . . . . The Congress that provided for diversity jurisdiction was concerned that a local jury sitting in state court might exhibit bias in favor of a ‘local’ party who was suing an out-of-state party. Because federal courts draw from a wider jury pool, . . . federal court, so the theory goes, provides a more neutral forum.”); see Caitlin Sawyer, Note, *Don’t Dissolve the “Nerve Center”: A Status-Linked Citizenship Test for Principal Place of Business*, 55 B.C. L. REV. 641, 646 & n.38 (2014); see also U.S. CONST. art. III, § 2, cl. 1 (extending judicial power “to controversies . . . between Citizens of different States”); *Smallwood v. Ill. Cent. R.R.*, 352 F.3d 220, 224 (5th Cir. 2003) (stating that one rationale underlying diversity jurisdiction is to “allow defendants to flee the state courts”); *Rooney v. Tyson*, 127 F.3d 295, 297 n.1 (2d Cir. 1997) (“[T]he object of diversity jurisdiction [is to present] the actual parties to a litigation with a neutral, federal, playing field.”).

opposing parties be citizens of different states.<sup>67</sup> Neither Article III of the Constitution nor § 1332, however, explicitly mention corporations.<sup>68</sup> As a result, courts have expressed some uncertainty over how corporations should be treated for purposes of diversity jurisdiction.<sup>69</sup>

*B. Diversity Jurisdiction and the Evolution of the Federal Court's Treatment of Corporations*

"A corporation is an inanimate entity . . . ."<sup>70</sup> When a group of persons establish themselves in accordance with certain legal rules, they collectively become an "artificial being" with a distinct legal personality.<sup>71</sup> Originally, the Supreme Court of the United States concluded a corporation in and of itself was "certainly not a citizen" for purposes of diversity jurisdiction; a corporation was instead a "mere legal entity" whose jurisdiction depended on the citizenship of each of its individuals members.<sup>72</sup> Prior to 1958, courts adhered to the "forum doctrine," which provided "that if a suit was brought by or against a corporation with multiple states of incorporation in one of its states of incorporation, . . . the [corporation] would be treated as if it were only a citizen of the forum state" for diversity purposes.<sup>73</sup> This view created a high potential

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67. 28 U.S.C. § 1332; *Strawbridge v. Curtiss*, 7 U.S. 267, 267 (1806), *overruled in part by* *Louisville, Cincinnati, & Charleston R.R. Co. v. Letson*, 43 U.S. 497 (1844), *superseded by statute*, Jurisdiction and Removal Act of 1875, ch. 137, § 2, 18 Stat. 470, 470–71 (current version at 28 U.S.C. § 1332). *See generally* *Gilbert v. David*, 235 U.S. 561 (1915); *Robertson v. Cease*, 97 U.S. 646 (1878). "A person is considered a citizen of a state if that person is domiciled within the state and is a citizen of the United States." WRIGHT ET AL., *supra* note 60, § 3611.

68. WRIGHT ET AL., *supra* note 60, § 3623.

69. *Id.*

70. Francis C. Amendola et al., 18 C.J.S. *Corporations* § 1, West (database updated Sept. 2018).

71. *Id.*

72. *Bank of United States v. Deveaux*, 9 U.S. 61, 86, 91–92 (1809), *overruled in part by* *Letson*, 43 U.S. 497, *superseded by statute*, Jurisdiction and Removal Act of 1875, ch. 137, § 2, 18 Stat. 470, 470–71 (current version at 28 U.S.C. § 1332 (2018)); *see also* WRIGHT ET AL., *supra* note 60, § 3522.

73. WRIGHT ET AL., *supra* note 60, § 3626. For example,

if a Massachusetts citizen had sued a Delaware and Massachusetts corporation in a federal court in Delaware, diversity would have existed because the corporation would have been considered a citizen solely of Delaware; however, if the action had been brought in a Massachusetts federal court, there would have been no diversity because the suit would have been treated as one between two Massachusetts citizens.

*Id.*

for abuse, however, as a corporation could easily attain a federal forum by merely reincorporating in a different state.<sup>74</sup>

Courts abandoned the forum doctrine in 1958 when Congress added § 1332(c) to title 28 of the United States Code, which provides that a corporation is a citizen of (1) any state in which it is incorporated *and* (2) the state where its principal place of business is located.<sup>75</sup> This “dual citizenship” standard was created as a way of reducing the number of corporate cases heard in the federal courts on the basis of diversity citizenship,<sup>76</sup> therefore easing the workload of federal judges<sup>77</sup> and preventing frauds on and abuses of federal jurisdiction.<sup>78</sup> The creation of dual citizenship for corporations also “reflected the reality that a corporation is unlikely to suffer out-of-state prejudice if it has its principal place of business in that state.”<sup>79</sup> Determining a corporation’s state of incorporation is a straight-forward inquiry, but uncovering a corporation’s principal place of business has always presented a complex inquiry for the federal courts – in both the pre-*Hertz* and post-*Hertz* legal landscape.

### 1. Determining Principal Place of Business Before *Hertz*

In the years following the enactment of § 1332(c) and before *Hertz* was decided by the Supreme Court of the United States, federal courts consulted

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74. See, e.g., *Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co.*, 276 U.S. 518 (1928) (finding a business was incorporated in one state for the sole purpose of forming a contract with a railroad company located in another state and to create diversity of citizenship and jurisdiction in the federal courts), *superseded by Hertz Corp. v. Friend*, 559 U.S. 77 (2010). Reincorporation in another state is a relatively easy process and most states provide step-by-step information about how to file the necessary paperwork for incorporation, most of which can be done online. See, e.g., *Starting a Business*, MO. SECRETARY OF ST., <https://www.sos.mo.gov/business/corporations/startbusiness> (last visited Oct. 23, 2018).

75. Pub. L. No. 85–554 § 2, 72 Stat 415 (1958) (codified as amended at 28 U.S.C. § 1332 (c)). Note that an individual is considered a citizen of the state in which she is domiciled under 28 U.S.C. § 1332(a). See 28 U.S.C. § 1332(a). The definitional difference between the citizenship of individuals and the citizenship of corporations is thought to “reflect[] the reality that a corporation may have a presence sufficient to render it a ‘citizen’ of more than one state.” Sawyer, *supra* note 66, at 646.

76. *Kelly v. U.S. Steel Corp.*, 284 F.2d 850, 852 (3d Cir. 1960). See generally *Canton v. Angelina Cas. Co.*, 279 F.2d 553 (5th Cir. 1960); *Nat’l Spinning Co. v. Washington*, 312 F. Supp. 958 (E.D.N.C. 1970); *Knee v. Chem. Leaman Tank Lines, Inc.*, 293 F. Supp. 1094, 1095 (E.D. Pa. 1968); *Carter v. Clear Fir Sales Co.*, 284 F. Supp. 386 (D. Or. 1967).

77. *Egan v. Am. Airlines, Inc.*, 324 F.2d 565, 565 (2d Cir. 1963); *Gilardi v. Atchison, Topeka & Sante Fe Ry. Co.*, 189 F. Supp. 82, 85 (N.D. Ill. 1960).

78. *Gilardi*, 189 F. Supp. at 85–86. For example, the “principal place of business” provision was necessary to remedy situations in which a wholly-local operation was deemed a citizen of a foreign state for diversity purposes merely because it happened to be incorporated there. *Id.*

79. Sawyer, *supra* note 66, at 647; see also WRIGHT ET AL., *supra* note 60, § 3624.

several multifactor tests when determining a corporation's principal place of business.<sup>80</sup> The following tests were predominantly employed by the courts in the pre-*Hertz* era: (1) the "center of corporate activity" test;<sup>81</sup> (2) the "nerve center" test;<sup>82</sup> and (3) the facts-and-circumstances-based "total activity" test, which represented a hybrid of the center of corporate activity and nerve center tests.<sup>83</sup> After analyzing the structure and activities of the corporation at issue, a federal court would select the test that seemed best suited to its inquiry of the "corporation's center of gravity" and apply it accordingly.<sup>84</sup> Courts differed somewhat in their formulation and application of these tests, which produced inconsistent results.<sup>85</sup>

Although the multifactor tests provided the courts with flexibility in determining a corporation's principal place of business, such flexibility came "at the expense of uniformity, predictability, and administrative simplicity."<sup>86</sup> The Supreme Court of the United States' landmark decision of *Hertz Corp. v.*

80. Sawyer, *supra* note 66, at 648.

81. *Id.* at 649. The "center of corporate activity" test concluded that a corporation's principal place of business was the place where a corporation's assets and day-to-day operations could be physically found. *Id.* This test focused primarily on visible, substantial operations of a corporation in a given state and was usually applied if a corporation had relatively centralized activities in one or a few states rather than spread across multiple states. See, e.g., *Grand Union Supermarkets of the Virgin Islands, Inc. v. H.E. Lockhart Mgmt., Inc.*, 316 F.3d 408, 411 (3d Cir. 2003). "This test was sometimes referred to as the 'place of operations' or the 'corporate operations' test." Sawyer, *supra* note 66, at 648 n.54. In the First Circuit, this approach became the "locus of operations" test. *Id.*

82. Sawyer, *supra* note 66, at 648. The nerve center was defined as the location "from which [a corporation's] officers direct, control, and coordinate" activities "in the furtherance of the corporate objective." *Id.* at 649 (citing *Scot Typewriter Co. v. Underwood Corp.*, 170 F. Supp. 862, 865 (S.D.N.Y. 1959)). "[C]ourts reasoned that the nerve center test should apply when the center of corporate activity test failed to identify the state in which the corporation was least likely to suffer prejudice in state courts." *Id.*

83. *Id.* Courts employed the total activity test to assess "the totality of the corporate existence." *Id.* Federal courts reasoned that the total activity test permitted flexibility "to account for differing activities and structures among corporations." *Id.* The implementation of this test was widely contested among federal courts of appeals, however. E.g., *id.* at 650 n.70; *Teal Energy USA, Inc. v. GT, Inc.*, 369 F.3d 873, 876 (5th Cir. 2004); *Capitol Indem. Corp. v. Russellville Steel Co.*, 367 F.3d 831, 836 (8th Cir. 2004), *abrogated by Hertz Corp. v. Friend*, 559 U.S. 77 (2010); *Gadlin v. Sybron Int'l Corp.*, 222 F.3d 797, 799 (10th Cir. 2000); *Gafford v. Gen. Electric Co.*, 997 F.2d 150, 162–63 (6th Cir. 1993), *abrogated by Hertz Corp.*, 559 U.S. 77; see also WRIGHT ET AL., *supra* note 60, § 3624.

84. Sawyer, *supra* note 66, at 648.

85. Jeffrey F. Ghent, Annotation, *Determination of Corporation's Principal Place of Business for Purposes of Diversity Jurisdiction Under 28 U.S.C.A. Section 1332(c)*, 6 A.L.R. Fed. 436, West (database updated weekly).

86. Sawyer, *supra* note 66, at 650 (citing *Hertz Corp.*, 559 U.S. at 92).

*Friend* in 2010 addressed these competing benefits and expenses and announced a uniform rule for courts to follow when tasked with making corporate citizenship determinations.

## 2. *Hertz Corp. v. Friend* and the "Nerve Center" Test for Determining Principal Place of Business

In 2010, the Supreme Court of the United States stated a clear rule for determining a corporation's principal place of business in *Hertz Corp. v. Friend*.<sup>87</sup> Writing for a unanimous Court, Justice Stephen G. Breyer announced that the appropriate test for determining the principal place of business was the "nerve center" approach,<sup>88</sup> which the Court believed would usually be found at the place where a corporation's "high level officers direct, control, and coordinate the corporation's activities" or at the corporation's headquarters.<sup>89</sup> In so holding, the Court expressly excluded the various preexisting multifactor approaches.<sup>90</sup>

Two fundamental rationales underpinned the Court's determination that the "nerve center" test was superior to the preexisting tests.<sup>91</sup> First, the Court reasoned that only one "prominent" place of business (i.e., "a single, determinable location within a state")<sup>92</sup> was contemplated by the text of § 1332(c)(1).<sup>93</sup> The Court further explained that this "prominent" location is not found in the state where the corporation enjoys its highest volume of business activity but is instead found in the state where the corporation's headquarters is located.<sup>94</sup>

Second, the Court stressed the importance of announcing a simple rule for corporate diversity jurisdiction that produces an efficient and predictable result, thus benefitting both the federal courts and corporations.<sup>95</sup> The Court noted that administrative simplicity is a "major virtue in a jurisdictional statute . . . [because c]omplex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court

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87. 559 U.S. 77.

88. In announcing the "nerve center" test, the Court essentially adopted the "nerve center" test first announced by the Southern District of New York in *Scot Typewriter Co. v. Underwood Corp.*, 170 F. Supp. 862, 864–65 (S.D.N.Y. 1959).

89. See *Hertz Corp.*, 559 U.S. at 88.

90. *Id.* at 92–93.

91. *Id.* at 93. Some scholars suggest that the *Hertz* Court provided a third rationale or consideration for deeming the "nerve center" test superior to other possibilities: legislative history. WRIGHT ET AL., *supra* note 60, § 3624.

92. Sawyer, *supra* note 66, at 651.

93. *Hertz Corp.*, 559 U.S. at 93. The statute references that "a corporation [is] deemed a citizen of every State and foreign state by which it has been incorporated" but only of "the State or foreign state where it has its principal place of business." 28 U.S.C. § 1332(c)(1) (2018) (emphasis added).

94. *Hertz Corp.*, 559 U.S. at 93.

95. *Id.* at 94.

is right to decide those claims.”<sup>96</sup> The Court advised, however, that ease of administration should not come at the expense of locating the “place of actual direction, control, and coordination” of a corporation.<sup>97</sup> The Court also cautioned against the potential for jurisdictional manipulation, stating that if “the alleged ‘nerve center’ is nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat . . . ,” then the true nerve center should be “the place of *actual* direction control and coordination.”<sup>98</sup>

### *C. The Problem with Defining a Holding Corporation’s Principal Place of Business Under Hertz*

The inherent difficulties in defining a corporation’s principal place of business under § 1332(c)(1) and in applying *Hertz*’s nerve center test are intensified by the abundance of corporate structures that exist in the twenty-first-century business world.<sup>99</sup> The *Hertz* Court anticipated such difficulties and forewarned that the “nerve center” test it adopted will not “automatically generate a result” in all instances.<sup>100</sup> The *Hertz* Court further accepted that the use of a “nerve center” test may sometimes “produce results that seem to cut against the basic rationale” for the diversity statute but stated that “accepting occasional[] counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration . . . .”<sup>101</sup>

Notwithstanding this dicta, in the years following the *Hertz* decision, federal courts have expressed uncertainty about whether *Hertz* precedent controls the principal place of business inquiry as applied to certain complex corporate structures in modern business.<sup>102</sup> In the same vein, the question of whether holding corporations in particular can be fairly analyzed according to *Hertz*’s

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96. *Id.* (citation omitted).

97. *Id.* at 97.

98. *Id.* (emphasis added).

99. *See id.* at 96 (observing that the principal place of business is less clear when the corporation’s headquarters is located in one state but its most visible activities occur in a different state); *see also* John T. Mitchell, *Home Is Where the Nerve Center Is: Locating a Corporation’s Principal Place of Business*, GPSOLO, Oct./Nov. 2011, at 36, 37–38 (observing that it is often difficult to locate the physical location of management’s decisions – particularly when a corporation’s meetings occur by teleconference); *Cent. W. Va. Energy Co., Inc. v. Mountain State Carbon, LLC*, 636 F.3d 101, 107 n.3 (4th Cir. 2011) (“[T]he proliferation of complex corporate structures among business enterprises may compel further attention to the issue of ‘principal place of business’ under 28 U.S.C. § 1332.”).

100. *Hertz Corp.*, 559 U.S. at 95–96.

101. *Id.* at 96.

102. *Cent. W. Va. Energy Co.*, 636 F.3d at 107 n.3 (“We recognize that the proliferation of complex corporate structures among business enterprises may compel further attention to the issue of ‘principal place of business’ under 28 U.S.C. § 1332.”).

nerve center test has been called into question.<sup>103</sup> This Section first describes the nature of holding corporations and the relationship they have to limited liability companies and then analyzes how the lower federal courts have conducted the principal place of business inquiry with respect to them.

### 1. The Nature of Holding Corporations

A holding corporation is “a corporation organized to hold the shares of another or other corporations.”<sup>104</sup> These shares are frequently held in limited liability companies.<sup>105</sup> “[T]he dominant characteristic of a holding company is the ownership of securities by which it is possible to control or substantially to influence the policies and management of one or more operating companies in a particular field of enterprise.”<sup>106</sup>

As of 2018, an increasing number of small business owners are formulating businesses according to the “holding company” structure.<sup>107</sup> A holding corporation can hardly be characterized as operating a normal business because it is designed to simply hold interest in other companies and has no principal

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103. *See id.*

104. 6A WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 2821, West (database updated Sept. 2018). A holding corporation, commonly called an umbrella company or parent company, is one that “owns a controlling interest in another company, called a subsidiary” or limited liability company. Jean Murray, *Should I Form a Holding Company for My Businesses?*, BALANCE, <https://www.thebalance.com/should-i-form-a-holding-company-for-my-businesses-3974575> (last updated Oct. 6, 2018).

105. Joshua Kennon, *Understanding a Holding Company: A Basic Introduction to Holding Companies & How They Work*, <https://www.thebalance.com/understanding-a-holding-company-357341> (last updated Oct. 16, 2018). The shares could also be held in limited partnerships, private equity funds, hedge funds, publicly traded stocks, bonds, real estate, song rights, brand names, patents, trademarks, copyrights, or virtually anything else with value. *Id.*

106. FLETCHER, *supra* note 104, § 2821 (quoting *N. Am. Co. v. Sec. & Exch. Comm’n*, 327 U.S. 686, 701 (1946)).

107. *See* Murray, *supra* note 104. There are several reasons that a holding company structure is appealing in the modern business world. *See* Jim Woodruff, *The Advantages of a Holding Company*, <https://smallbusiness.chron.com/advantages-holding-company-24217.html> (last updated June 29, 2018). Because the holding company structure allows for ownership and control of many different companies, a holding company will likely be able to obtain certain tax-free dividends, depending on what percentage of ownership an investor holds. *Id.* In addition, holding companies may benefit from reduced risk exposure – as compared to a traditional business model – because the only risk the holding company has is the capital it invested at the outset. *See id.* The holding company also often benefits from the goodwill and reputation of the other companies it owns and controls while being sheltered from risks faced by the other companies in the case of legal issues, tax liabilities, and lawsuits. *See id.* Further, the creation of a holding company provides several perks related to the diversity of assets, increased raising of capital, borrowing and lending money with the other companies, and corporate policymaking. *Id.*



place of business in way the term is commonly construed. Despite its unusually low levels of activity, however, a holding corporation continues to legally exist, and the nature of its structure raises important questions regarding jurisdictional citizenship.

The relationship between a holding corporation and a limited liability company is rather unique. A limited liability company is treated as a partnership rather than a corporation in the eyes of the law, and its citizenship is determined by the citizenship of its members.<sup>108</sup> Thus, in determining a limited liability company's principal place of business for diversity jurisdiction purposes, a court must look to the citizenship of each of its members.<sup>109</sup> Because a holding corporation is frequently the sole member of a limited liability company, a holding corporation's citizenship often plays a controlling role in determining the citizenship of a limited liability company.

Generally, a holding corporation has a separate corporate existence from its operating companies and is to be treated as a separate entity, despite its aforementioned ability to exert control or influence over those companies.<sup>110</sup> But if the holding company was created as "a mere sham" or if the holding company's organization and control indicates that it is simply an instrumentality of another corporation – otherwise referred to as an "alter ego" – then the holding company will not be viewed as having a legally separate identity and will take on the citizenship of the company over which it exerts control.<sup>111</sup>

## 2. The Principal Place of Business Problem for Holding Corporations After *Hertz*

Few federal court decisions have addressed how the "atypical factual scenario"<sup>112</sup> presented in cases that involve holding corporations should be squared with *Hertz* precedent. Indeed, the U.S. Court of Appeals for the Third Circuit is the only federal appellate court to grapple with *Hertz*'s application to holding corporations as of the time this Note was written. This Section examines the Third Circuit's decision in *Johnson v. SmithKline Beecham Corp.*<sup>113</sup>

In *Johnson*, two joint plaintiffs filed a personal injury action against a defendant limited liability company ("GSK LLC") with a holding company

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108. *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412, 420 (3d Cir. 2010); *Brewer v. SmithKline Beecham Corp.*, 774 F. Supp. 2d 720, 725 (E.D. Pa. 2011).

109. *Zambelli*, 592 F.3d at 420; *Brewer*, 774 F. Supp. 2d at 725.

110. FLETCHER, *supra* note 104, § 2821.

111. *Id.*; *see also* *Danjaq, S.A. v. Pathe Commc'ns Corp.*, 979 F.2d 772, 775 (9th Cir. 1992) (discussing the possibility of an alter ego relationship between a holding company and a subsidiary).

112. *Brewer*, 774 F. Supp. 2d at 725.

113. 724 F.3d 337 (3d Cir. 2013).

(“GSK Holdings”) as its single member.<sup>114</sup> One plaintiff was a citizen of Louisiana.<sup>115</sup> The other plaintiff was a citizen of Pennsylvania.<sup>116</sup> The citizenship of GSK Holdings and – by extension – GSK LLC was disputed by the parties.<sup>117</sup> GSK Holdings was incorporated in Delaware but engaged in very limited activities in that state.<sup>118</sup> GSK Holdings’ three-person board of directors held short (fifteen-to-thirty minute) quarterly board meetings in Wilmington, Delaware, with some members appearing telephonically.<sup>119</sup> At the time the *Johnson* lawsuit was filed, GSK Holdings had conducted approximately forty board meetings.<sup>120</sup>

The extent of the actual decision-making that occurred at GSK Holdings’ board meetings was disputed by the parties.<sup>121</sup> The plaintiffs argued the board meetings served “merely to ratify decisions” that were actually made in Pennsylvania and that diversity jurisdiction was improper.<sup>122</sup> The defendants maintained GSK Holdings’ directors “reached decisions about [the corporation’s] investments only at [the Wilmington, Delaware,] board meetings and based on their own independent judgment” and that diversity jurisdiction was proper.<sup>123</sup> The Third Circuit agreed with the defendants, holding that GSK Holdings’ principal place of business, or “nerve center,” was Delaware because the “‘single direction’ in which the nerve center test points [wa]s towards the location of [the holding company’s] decisions to adopt binding resolutions affecting the corporation’s investments.”<sup>124</sup> Thus, by extension, the Third Circuit held that GSK LLC’s principal place of business was also Delaware.<sup>125</sup>

The plaintiffs relied on a “delegation theory” to support their position that GSK Holdings’ principal place of business was Pennsylvania,<sup>126</sup> which was proposed in related litigation about the proper nerve center of GSK Holdings

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114. *Id.* at 340–41.

115. *Id.* at 340.

116. *Id.*

117. *Id.* at 340–41.

118. *Id.* at 340, 342–43.

119. *Id.* at 342.

120. The holding company at issue in *Johnson* had been conducting short board meetings in Wilmington, Delaware, quarterly since 2001, and the *Johnson* lawsuit was filed on August 26, 2011. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.* at 356; *see also* *Hertz Corp. v. Friend*, 559 U.S. 77, 96 (2010) (reasoning that “the ‘nerve center’ test ‘points courts in a single direction, toward the center of overall direction, control and coordination.’”).

125. *Johnson*, 724 F.3d at 356.

126. *Johnson*, 724 F.3d at 349. The plaintiffs also argued that, when looking solely at the activities of GSK Holdings, it was clear that GSK Holdings’ principal place of business is located in Pennsylvania. *Id.* Based on all the evidence presented in the case, the Third Circuit held that GSK Holdings’ activities of direction, coordination and control took place in Wilmington, Delaware. *Id.* at 354–56.

and which was rooted in a series of opinions written by Judge Timothy J. Savage on the U.S. District Court for the Eastern District of Pennsylvania – *Patton*,<sup>127</sup> *Maldonado*,<sup>128</sup> and *Brewer*.<sup>129</sup> The plaintiffs argued that, when making the principal place of business determination for GSK Holdings, the court should have considered GSK LLC’s activities because GSK Holdings delegated its authority to manage GSK LLC to GSK LLC’s managers.<sup>130</sup>

The Third Circuit acknowledged the plaintiffs’ proposed theory but did not ultimately find it persuasive.<sup>131</sup> The Third Circuit held that the delegation theory’s influence on the nerve center test ignores well-established precedent that “a parent corporation maintains separate citizenship from its subsidiary unless it has exerted such an overwhelming level of control over the subsidiary that the two companies do not retain separate identities.”<sup>132</sup> The Third Circuit also rejected Judge Savage’s reasoning in *Brewer* that “[w]here the sole member of a limited liability company is a holding company . . . [, the court is] presented with an anomaly in applying the ‘nerve center’ test,” and should take the limited liability company’s activities into consideration, despite the well-settled principle that the citizenship of a limited liability company is determined by the citizenship of each of its members.<sup>133</sup>

The Third Circuit concluded the corporate structure existing between GSK Holdings and GSK LLC was “hardly anomalous” and further asserted that holding companies are “ubiquitous, especially in large business enterprises,” and pre-*Hertz* courts “have been determining their nerve centers for decades.”<sup>134</sup> As a result, the Third Circuit held the fact that a holding company holds a limited liability company “does not, in itself, complicate the nerve center analysis” announced in *Hertz*.<sup>135</sup>

Despite the foregoing conclusion, the Third Circuit concluded that the dicta in *Hertz*, which cautioned courts to consider that a corporation’s nerve center is normally “not simply an office where the corporation holds board meetings,” was inapplicable when the corporation at issue is a holding company.<sup>136</sup> According to the Third Circuit, “the kind of board meetings denigrated in *Hertz* were being considered in the context of a case involving a

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127. *Patton ex rel. Daniels–Patton v. SmithKline Beecham Corp.*, 2011 WL 6210724 (E.D. Pa. Dec. 14, 2011).

128. *Maldonado ex rel. Maldonado v. SmithKline Beecham Corp.*, 841 F. Supp. 2d 890 (E.D. Pa. 2011).

129. *Brewer v. SmithKline Beecham Corp.*, 774 F. Supp. 2d 720 (E.D. Pa. 2011). *Brewer* provided the core of the analysis of the two explanations provided. *Johnson*, 724 F.3d at 349 n.13 (citing *Brewer*, 774 F. Supp. 2d at 729–32).

130. *Id.* at 349.

131. *Id.* at 352–53.

132. *Id.* at 351.

133. *Id.* at 351 (first and second alteration in original); see *supra* Section III.C.1.

134. *Johnson*, 724 F.3d at 351.

135. *Id.*

136. *Id.* at 347 (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 93 (2010)).

sprawling operating company with extensive activities . . . ."<sup>137</sup> In distinguishing the holding of the Court in *Hertz*, the Third Circuit noted that, when the company at issue is merely a holding company, "relatively short, quarterly board meetings may well be all that is required to direct and control the company's limited work."<sup>138</sup> It concluded that, in cases involving holding companies, "[t]he location of board meetings is . . . a more significant jurisdictional fact . . . than it was in *Hertz*, and the meetings' brevity does not necessarily reflect an absence of substantive decision-making."<sup>139</sup>

Judge Thomas L. Ambro concurred in part and concurred in the judgment but wrote a separate opinion because he feared the majority's conclusion regarding the principal place of business of GSK Holdings was "in tension with *Hertz*."<sup>140</sup> Judge Ambro expressed skepticism that a corporation's status as a holding company must change the *Hertz* analysis.<sup>141</sup> Indeed, Judge Ambro noted the *Johnson* majority did not point to any case endorsing its view that sole reliance on the location of the board of directors meetings can properly determine a holding company's principal place of business.<sup>142</sup>

Judge Ambro worried that the majority's approach in *Johnson* "w[ould] encourage parties to shift the location or formal authority of their corporate boards in order to create citizenship where those board meetings are held."<sup>143</sup> Further, Judge Ambro cautioned that "unless *Hertz* is changed or clarified by the Supreme Court [of the United States], [the Third Circuit's holding] sets an incorrect precedent that will affect corporate citizenship rulings in future cases."<sup>144</sup> According to Judge Ambro, the nerve center test should "appl[y] uniformly to all companies unless the Supreme Court [of the United States says] otherwise."<sup>145</sup>

#### IV. INSTANT DECISION

Part IV examines several facets of the Ninth Circuit's *3123 SMB LLC* decision. First, Section A dissects the majority opinion's holding and reasoning, as authored by Judge Jacqueline H.N. Nguyen. Second, Section B analyzes the reasoning presented in Judge Andrew D. Hurwitz's dissent.

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137. *Id.* at 354 (quotations omitted).

138. *Id.*

139. *Id.*

140. *Id.* at 361 (Ambro, J., concurring). Judge Ambro believed that GSK Holdings' principal place of business was located in the United Kingdom rather than Pennsylvania or Delaware. *Id.*

141. *Id.* at 361–62. Judge Ambro said this was so even though the company at issue in *Hertz* was an operating company. *Id.* at 362.

142. *Id.* at 362.

143. *Id.* at 364.

144. *Id.* at 361.

145. *Id.* at 364.

### A. The Majority Opinion

In *3123 SMB LLC v. Horn*, the Ninth Circuit held – as a matter of first impression – that, for purposes of diversity jurisdiction, “a recently-formed holding company’s principal place of business is the place where it plans to hold its board meetings, regardless of whether any meetings have occurred prior to filing a lawsuit, unless evidence shows that the corporation is directed from elsewhere.”<sup>146</sup>

The court reached this conclusion in three steps. First, the court set out the well-established, general rules for determining corporate citizenship when a lawsuit involves a limited liability company and a holding corporation.<sup>147</sup> Second, much like Prince Charming’s attempt in Disney’s *Cinderella* to find his true love by conducting the “glass slipper test,” the Ninth Circuit sought the “perfect fit” for the Corporation in *3123 SMB LLC* by comparing its activities to preexisting case law involving holding companies as well as companies otherwise deemed inactive.<sup>148</sup> Third, with the foregoing in mind, the court ultimately returned to the language of *Hertz* and, with *Hertz* as a guide, developed its own approach for classifying the Corporation’s citizenship in *3123 SMB LLC*.<sup>149</sup>

#### 1. The Corporation and the LLC Have Distinct Legal Identities

At the outset, the Ninth Circuit echoed the well-established rule that, “[f]or purposes of diversity jurisdiction, a limited liability company ‘is a citizen of every state of which its owners/members are citizens.’”<sup>150</sup> Therefore, because the Corporation was the sole member of the LLC in *3123 SMB LLC*, the court concluded the Corporation’s citizenship was dispositive on the issue of whether Horn and the LLC were diverse.<sup>151</sup>

Applying the *Johnson* rule regarding the existence of an alter ego relationship<sup>152</sup> to the facts of *3123 SMB LLC v. Horn*, the Ninth Circuit concluded that the identities, and therefore the citizenship, of the Corporation and the LLC

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146. *3123 SMB LLC v. Horn*, 880 F.3d 461, 468 (9th Cir. 2018).

147. *Id.* at 465–67.

148. *Id.* at 467–68.

149. *Id.* at 468–70.

150. *Id.* at 465 (quoting *Johnson v. Columbia Props. Anchorage, LP*, 437 F.3d 894, 899 (9th Cir. 2006)).

151. *Id.*

152. The citizenship of a holding corporation is separate and distinct from that of its subsidiary limited liability company “unless it has exerted such an overwhelming level of control over” the limited liability company. *Id.* at 467 (quoting *Johnson v. SmithKline Beecham Corp.*, 724 F.3d 337, 351 (3d Cir. 2013)); see *supra* Section III.C.2.

must be considered separate and distinct because no clear evidence supported the view that the two companies were alter egos.<sup>153</sup>

## 2. The Ninth Circuit's Application of *Hertz* to Holding Corporation and Inactive Corporation Precedent

The Ninth Circuit acknowledged that the appropriate method for determining a corporation's citizenship is to apply the "nerve center" test established by the Supreme Court of the United States in *Hertz*, which stipulates that a corporation's principal place of business

should normally be the place where the corporation maintains its headquarters – provided that the headquarters is the actual center of direction, control, and coordination . . . and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion).<sup>154</sup>

Because a holding company engages in low levels of activity by its very nature, the Ninth Circuit classified such companies as "not normal" and looked to how other jurisdictions have applied *Hertz* to corporations that have been deemed atypical.<sup>155</sup> The Ninth Circuit spent considerable time analyzing how the Third Circuit applied *Hertz*'s definition of corporate citizenship to a holding company in *Johnson*.<sup>156</sup> It concluded, however, that the Corporation at issue in *3123 SMB LLC* was even less active than the corporation analyzed in *Johnson*, as it was a mere twenty-five days old on the date the lawsuit was filed in federal court, and incorporating was the only business it had conducted in that brief window.<sup>157</sup>

The Ninth Circuit also looked at how other jurisdictions have applied *Hertz* to the "somewhat analogous context" of corporations that are in the process of dissolving and are otherwise inactive.<sup>158</sup> Although the court acknowledged that the U.S. Courts of Appeal for the Third and Eleventh "[C]ircuits have [ruled] that a dissolved corporation has no principal place of business for

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153. *3123 SMB LLC*, 880 F.3d at 468. The Ninth Circuit suggested the Central District of California may have erroneously believed that an alter ego relationship existed between the Corporation and the LLC because the two entities are both managed by the Klings and utilize the same Missouri-based attorneys. *Id.*

154. *Id.* at 465 (alteration in original) (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 93 (2010)).

155. *Id.*

156. *Id.* at 465–66. The Ninth Circuit also analyzed how the First Circuit made a finding of corporate citizenship involving a holding company in the pre-*Hertz* case of *Taber Partners, I v. Merit Builders, Inc.*, 987 F.2d 57 (1st Cir. 1993). *3123 SMB LLC*, 880 F.3d at 466–67.

157. *Id.* at 467. The Corporation in *Johnson*, on the other hand, had held forty board meetings at the time its lawsuit was filed. See *supra* note 120 and accompanying text.

158. *Id.*

diversity purposes[] and is therefore only a citizen of its state of incorporation,” the Ninth Circuit recalled that it described the notions suggested by those circuits as logically “perverse” in a previous decision without taking a definitive stance.<sup>159</sup> Even though the Ninth Circuit did not announce how it thought “inactive” corporations should be treated in a principal place of business inquiry, it concluded, in stark opposition to the findings of the Central District of California, that “[the Corporation in 3123 SMB LLC], which doesn’t do much at all, did nothing for [twenty-five] days.”<sup>160</sup>

### 3. The Ninth Circuit’s Determination that the Corporation’s Principal Place of Business is in Missouri

The Ninth Circuit next wrestled with crafting the citizenship classification for the Corporation. The Ninth Circuit determined that the Corporation’s principal place of business was Missouri because the Corporation’s registered office, where annual board meetings were to be held, was in Clayton, Missouri.<sup>161</sup> The Ninth Circuit further held that this rule should control regardless of whether any annual meetings have actually taken place at the time the lawsuit is filed.<sup>162</sup>

The Ninth Circuit determined the Central District of California’s holding – that 3123 SMB put forth no evidence that Lincoln One’s operations were directed, controlled, or coordinated from Missouri or anywhere other than California – rested on two improper assumptions: (1) “that a holding company’s principal place of business is by default in the state where its officers live” and (2) “that [a holding company’s] principal place of business can change over time as the company holds a sufficient number of board meetings at its true nerve center.”<sup>163</sup>

First, the Ninth Circuit held that to assume “a holding company’s principal place of business is in the state where its officers reside is problematic” because corporations are not typically directed from their officer’s homes.<sup>164</sup>

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159. *Id.* at 467; *see also, e.g.,* Holston Invs., Inc. B.V.I. v. LanLogistics Corp., 677 F.3d 1068, 1071 (11th Cir. 2012) (holding that such a rule “aligns most closely with the Supreme Court[ of the United States’] analysis in *Hertz*”); *Midlantic Nat’l Bank v. Hansen*, 48 F.3d 693, 698 (3d Cir. 1995) (rejecting any notion that all corporations must have a principal place of business). Although the issue of how an inactive holding corporation should be treated for diversity purposes reached the Ninth Circuit in *Co-Efficient Energy Sys. v. CSL Industries, Inc.*, 812 F.2d 556 (9th Cir. 1987), the court in 3123 SMB LLC concluded the corporation at issue in that case was indeed active, as the corporation’s director and sole shareholder “made business decisions, including the decision to contract with [the defendant] and file [that] action.” 3123 SMB LLC, 880 F.3d at 467 (first alteration in original) (quoting *Co-Efficient Energy*, 812 F.2d at 558)).

160. 880 F.3d at 468.

161. *Id.* at 471.

162. *Id.* at 468.

163. *Id.* at 469.

164. *Id.*

The Ninth Circuit further reasoned that the place where a holding company's officers reside, without the accompaniment of a designated office space, is problematic because *Hertz* requires that a corporation's principal place of business "is a place *within* a State. It is not the State itself."<sup>165</sup> Based on this interpretation, the Ninth Circuit held the Central District of California erred in finding the Corporation's principal place of business to be California because its inquiry failed to divulge a *single* place within the State of California, such as an office space, from which Mary Kling orchestrated the Corporation's activities.<sup>166</sup> The Ninth Circuit further advised that a rule that looks to the state where a holding company's officers reside would be unworkable in most instances, as holding companies often have more than one decisionmaker living in more than one state.<sup>167</sup>

Second, the Ninth Circuit held that to assume "a corporation's principal place of business can shift over time without any change to the corporation's structure or operation" would invite more litigation and lead to the sort of strange results the Supreme Court of the United States warned against in *Hertz*.<sup>168</sup> The Ninth Circuit noted that although in *3123 SMB LLC* the corporate entity was the plaintiff, it will be the defendant in many circumstances.<sup>169</sup> To hold that its principal place of business could change over time "would turn on happenstance" – i.e., if a holding company had not held a sufficient number of board meetings prior to being sued, then its citizenship would be determined by the mere residence of one of its officers.<sup>170</sup>

The Ninth Circuit advocated a separate reason in support of its holding that a holding company's principal place of business should be the place it plans to hold its annual meetings: "administrative simplicity."<sup>171</sup> The Ninth Circuit reasoned that

[a] rule that forces courts to pick a nerve center from the potentially several states where corporate decision-makers reside and to determine whether there have been enough board meetings to establish a different nerve center would be difficult to administer and generate unnecessary litigation on collateral issues. In contrast, a rule presuming that from

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165. *Id.* (emphasis in original) (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 93 (2010)).

166. *Id.*

167. *Id.*

168. *Id.* (citing *Hertz Corp.*, 559 U.S. at 94). In *Hertz*, the Supreme Court of the United States held that "measuring the total amount of business activities that the corporation conducts there and determining whether they are significantly larger than the next-ranking [s]tate" would lead to strange results because certain states have much larger populations than others, which could throw off the analysis. *Hertz Corp.*, 559 U.S. at 93–94.

169. *3123 SMB LLC*, 880 F.3d at 469.

170. *Id.*

171. *Id.* at 469–70.



inception a holding company directs its business from the place where it holds its board meetings is easy to apply.<sup>172</sup>

Notwithstanding its aforementioned holding, the Ninth Circuit noted the record in *3123 SMB LLC* included evidence from which an “inference [of jurisdictional manipulation] could be made.”<sup>173</sup> The Ninth Circuit admitted that the Corporation’s timely incorporation – which occurred roughly one month before the filing of this suit in federal court, near the end of the relevant statute of limitations, and just before it brought separate claims arising from Horn’s professional mistakes in parallel state court litigation – gave rise to concerns of jurisdictional manipulation.<sup>174</sup> However, the court also noted the record contained evidence suggesting the Corporation was incorporated in Missouri for legitimate reasons, such as the Klings’ familial and business ties to Missouri and the presence of their attorney in Missouri.<sup>175</sup>

Ultimately, the court reversed the district court’s dismissal for lack of subject matter jurisdiction with the accompanying condition that upon remand the district court was “free to consider whether there is jurisdictional manipulation or an alter ego relationship between [the Corporation] and [the LLC].”<sup>176</sup>

### *B. The Dissenting Opinion*

In his dissent, Judge Hurwitz argued that the Corporation’s “nerve center,” as determined at the time the lawsuit was filed, was California.<sup>177</sup> In Judge Hurwitz’s view, the Central District of California correctly found that the Corporation’s nerve center was California because California was where the Corporation’s shareholders and directors resided.<sup>178</sup> Judge Hurwitz reasoned that a holding company’s “‘nerve center’ cannot be in a state where the corporate EEG is flat.”<sup>179</sup> Put another way, Judge Hurwitz emphasized that a corporation’s principal place of business cannot be “located in a state in which the company ha[s] done absolutely no business at the time the [federal] lawsuit was filed.”<sup>180</sup> Therefore, under Judge Hurwitz’s view, the fact that a board

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172. *Id.* at 470 (citing *Johnson v. SmithKline Beecham Corp.*, 724 F.3d 337, 355 (3d Cir. 2013)). The court further cited that “[e]ven while cautioning courts to identify a corporation’s actual center of direction and control, *Hertz* ‘place[d] primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible.’” *Id.* (quoting *Hertz Corp. v. Friend*, 559 U.S. 77, 80 (2010)).

173. *Id.* at 470–71.

174. *Id.* at 471.

175. *Id.*

176. *Id.*

177. *Id.* (Hurwitz, J., dissenting).

178. *Id.*

179. *Id.*

180. *Id.*

meeting was *later* held by the Corporation in Missouri should not have been considered in making the jurisdictional determination in the instant case.<sup>181</sup>

Judge Hurwitz wrote that the Central District of California's finding that the Corporation's principal place of business was California was not clearly erroneous because the LLC freely "conceded that there had been no corporate activity in Missouri between the day [the Corporation] was incorporated and the filing of [its] lawsuit."<sup>182</sup> Even if the majority's premise that the Corporation was completely inactive during the relevant period was adopted, Judge Hurwitz reasoned that the district court's dismissal must still be affirmed because the LLC "presented absolutely no evidence that any . . . direction, control, or coordination [of the Corporation] occurred in Missouri."<sup>183</sup> In Judge Hurwitz's view, the majority improperly relied on *Johnson* for the proposition that a holding company's "nerve center" is where its board meetings are supposed to take place.<sup>184</sup> Judge Hurwitz found *Johnson* distinguishable because the board meetings at issue therein had *actually taken place* in Delaware before the lawsuit was filed.<sup>185</sup> In contrast, no board meetings had been held by the Corporation in *3123 SMB LLC* before the LLC filed its lawsuit.<sup>186</sup>

According to Judge Hurwitz, the majority's rule "gives rise to the very dangers of jurisdictional manipulation that *Hertz* eschews."<sup>187</sup> Judge Hurwitz found it concerning that the majority's analysis allowed for "[the Corporation], having established diversity simply by virtue of its state of incorporation . . . [to] safely conduct its business entirely in California but still invoke the limited jurisdiction of an Article III court."<sup>188</sup>

## V. COMMENT

In *3123 SMB LLC*, the Ninth Circuit decided the place where a holding corporation merely anticipates holding its board meetings is sufficient to establish its principal place of business<sup>189</sup> – rendering itself the first circuit to provide a federal forum to a litigant on the basis of future intentions. In an unprecedented opinion, the Ninth Circuit determined a corporation's "nerve center" could be located in a state where the corporation had conducted no business activity whatsoever – despite the fact that neither *Hertz* precedent nor the leading persuasive authority from the Third Circuit in *Johnson* articulated such a rule.

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181. *See id.* at 471–72.

182. *Id.* at 472.

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.* at 473.

188. *Id.*

189. *Id.* at 468.

First, this Part argues the Ninth Circuit's proposed "future board meetings" test for newly-formed holding corporations is problematic because it cuts against the purpose of the diversity statute in a manner not anticipated by the Supreme Court of the United States. Second, this Part argues the Ninth Circuit's decision produces a result that is even further at odds with *Hertz* than the Third Circuit's *Johnson* decision. Finally, this Part argues the Ninth Circuit's holding effectively carves out a "holding company exception" to *Hertz*,<sup>190</sup> examines the long-lasting implications of *3123 SMB LLC*, and explores the multiple avenues that could be pursued by the courts and/or the legislature to force the problematic holdings announced by the Third and Ninth Circuits into compliance with *Hertz* precedent.

*A. The Ninth Circuit's Decision in 3123 SMB LLC Defies the Purpose of the Diversity Statute Beyond the Supreme Court of the United States Anticipation*

It is well-established that the purpose of diversity jurisdiction is to prevent the potential for unfair prejudice when an out-of-state litigant is hailed to court in a different state.<sup>191</sup> In determining whether prejudice exists, emphasis is placed on the visibility of the corporation's activities to the public.<sup>192</sup> If the prejudice determination turns on the corporation's visible activities to the public, then it is unlikely that the LLC at issue in *3123 SMB LLC* would suffer a risk of unfair prejudice if it was asked to litigate in California state court. Casting aside the legal reality that a limited liability company takes on the citizenship of each of its members for a moment, the LLC in *3123 SMB LLC* is undoubtedly visible in California and has a principal place of business located in California. Similarly, Horn is undoubtedly visible in California because he is domiciled and maintains his law practice there.

The Supreme Court of the United States conceded in *Hertz* that anomalies may exist even after the adoption of the "nerve center" test, producing "results that seem to cut against the basic rationale" for the diversity statute.<sup>193</sup> The Court reasoned that "accepting occasional[] counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration . . . ," and this result must be tolerated for the greater good.<sup>194</sup> However, the consequence of the "future board meetings" principal place of business standard for newly-formed holding corporations will be that an onslaught of cases may yield counterintuitive results, far exceeding the "occasional" anomalous result that the Court was prepared to acknowledge in *Hertz*. Because the holding corporation model is being pursued with more frequency in the twenty-first-century business world and because lower federal courts clearly consider

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190. See *supra* note 10.

191. WRIGHT ET AL., *supra* note 60, § 3624.

192. See *id.*

193. *Hertz Corp. v. Friend*, 559 U.S. 77, 96 (2010).

194. *Id.*

the principal place of business of the holding corporation (when it is a member of a limited liability company) as determinative of the limited liability company's principal place of business, the primary purpose of the diversity statute will be disregarded in more instances than originally anticipated by the Court in *Hertz* if the Ninth Circuit's holding is followed as precedent.

*B. The Ninth Circuit's Reliance on Johnson and Decision in 3123 SMB LLC Both Defy Hertz Precedent*

The Third Circuit's decision in *Johnson* is at odds with *Hertz* precedent because it suggests that board meetings are somehow more jurisdictionally significant when the corporation at issue is a holding corporation. This analysis seemingly endorses a reversion back to the multifactor, "flexible" tests applied piecemeal by the federal courts in the pre-*Hertz* era, muddling the bright line rule announced by the Court in *Hertz*.<sup>195</sup>

The Ninth Circuit's decision in *3123 SMB LLC* is also at odds with *Hertz* precedent and, in fact, takes the risky analysis presented in *Johnson* one step further. While *Johnson* may have barely cracked open the door to treating the holding of board meetings as sufficient to establish jurisdiction in the case of a holding company, *3123 SMB LLC* pushes that door wide open.

The Ninth Circuit's decision in *3123 SMB LLC* meaningfully departs from *Hertz*. The Ninth Circuit's determination that corporate citizenship must turn on wherever a corporation lists that it will hold board meetings is inconsistent with *Hertz* dicta and produces a perplexing result as a matter of policy. If the corporate citizenship determination turns on the concept of the intended location of board meetings— as the Ninth Circuit suggests — then it will be all too easy for small-business-owner-plaintiffs to create a holding corporation by filing the necessary and straightforward articles of incorporation in its desired forum, write down that it intends to hold board meeting in its desired forum, and secure its "principal place of business" in the state of its choosing.

In *Hertz*, the Court declared, "[T]he mere filing of a form, like the Securities and Exchange Commission's Form 10-K listing a corporation's 'principal executive offices' would, without more, be insufficient proof to establish a corporation's 'nerve center.'"<sup>196</sup> The *Hertz* Court further emphasized that a corporation should not be permitted to establish citizenship in a place where it "[has a] bare office with a computer" or hosts "an annual executive retreat."<sup>197</sup> And yet, this is precisely what the Third Circuit allowed in *Johnson* and what the Ninth Circuit further justified in *3123 SMB LLC* when reasoning that the weight of the Court's cautionary language in *Hertz* is somehow less applicable to holding corporation structures.

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195. See *supra* text accompanying notes 80–86 (explaining the pre-*Hertz* tests for principal place of business).

196. *Hertz Corp.*, 559 U.S. at 97.

197. *Id.*

The corporate citizenship inquiry must instead be based on where the corporation's high level officers are *actually* controlling its activities at the time the lawsuit is filed. It is unconvincing that the simple filing of articles of incorporation and listing of an address offer enough evidence of a corporation's genuine intent to conduct business in a particular state. These sorts of activities are what the Court in *Hertz* rejected as being not enough, "without more," to establish a nerve center.<sup>198</sup> Similarly, the simple holding of a board meeting should not be treated as sufficient evidence of a holding corporation's intent to conduct business in a particular state and should be placed in the category of activities that are not enough, "without more," to establish a "nerve center." Because a newly-formed holding corporation could easily hold a quick board meeting immediately upon its incorporation, the concept of board meetings cannot be the lynchpin of the principal place of business portion of the citizenship analysis. When courts attempt to discern an individual person's domicile for diversity of citizenship purposes, they focus not only on residence (i.e., where the individual is physically located) but also on the individual's intent to remain in the state as well.<sup>199</sup> The Court in *Hertz* announced a "nerve center" test with a similar intent requirement for corporate citizenship – and its rule rightfully placed significant emphasis on the intent of the corporation's *officers* and their location when decisions are made.

The intent of the corporation's officers to conduct business in a particular state should be properly discerned by looking to the primary purpose of the corporation at issue, regardless of how that corporation is structured. If the primary purpose of a corporation is to give direction to another company, as was true of the Corporation at issue in *3123 SMB LLC*, then the corporation's principal place of business must be where its high-level officers made management decisions at the time the lawsuit at issue was filed. This standard produces results that are consistent with the "nerve center" rule announced in *Hertz* because it places emphasis on the brain power of the corporation and points to a single place within a state.

In *3123 SMB LLC*, the place where any and all decisions about the Corporation, as well as any direction it gave to the LLC, had been given at the time the lawsuit was filed was California. California was where Mary Kling – the Corporation's only high-level officer – provided direct, day-to-day managerial control of all Corporate activities, and the record was devoid of evidence that she made any decision elsewhere. Therefore, in accordance with *Hertz* precedent, the Ninth Circuit should have found California the Corporation's principal place of business for diversity purposes and denied the Klings a federal forum.

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198. *Id.* at 97.

199. WRIGHT ET AL., *supra* note 60, § 3612.

*C. Implications of the 3123 SMB LLC Decision and Suggestions for the Future*

The Ninth Circuit's decision in *3123 SMB LLC* will have long-lasting effects on the federal court system. Its holding – that a recently-formed holding company's principal place of business is the place where it plans to hold its board meetings, regardless of whether any meetings have occurred prior to filing a lawsuit – will cause the federal courts to be flooded with lawsuits. Business litigants seeking a more favorable forum may be tempted to create the type of business arrangement blessed by the Ninth Circuit solely to take advantage of federal diversity jurisdiction.

The more significant effect of the Ninth Circuit's opinion is that it joins the Third Circuit in articulating a faulty "holding company exception" to *Hertz*.<sup>200</sup> The Ninth Circuit's endorsement of the Third Circuit's view that holding companies should be treated differently than other forms of corporation's under *Hertz* will result in a fracturing of precedent across the federal circuits. Different courts will devise different tests to discern the citizenship of complex businesses. This result will achieve the opposite of the administrative simplicity. Treating holding corporations as distinct from other types of corporations may very well open the door to the court's treatment of each and every kind of complex corporate structure imaginable as uniquely situated in the "nerve center" analysis.<sup>201</sup> Such an approach would allow the exception to swallow the rule; the proposed exception would subvert the "nerve center" rule and undermine the very certainty the Court sought to establish in *Hertz*.

There are several avenues that the courts and/or the legislature could pursue to rectify the holdings of the Third Circuit in *Johnson* and the Ninth Circuit in *3123 SMB LLC*. First, although it is likely the most unsatisfactory of all the options described, Congress and the federal courts could wait for this line of cases to reach the Supreme Court of the United States so that *Hertz* may be clarified and a definitive answer regarding the principal place of business inquiry for holding corporations may be announced. Second, the courts could announce a rule similar to the one announced by Judge Savage in *Brewer* that LLC's should not be treated as separate entities when their parent corporation is a holding corporation.<sup>202</sup> For example, the courts could determine that if a holding corporation and its limited liability company share the same business activities and high level officers, the two companies should be presumed to hold an alter ego relationship. The federal courts could carve out special treatment for holding corporation structures within the alter ego relationship theory rather than carve out an exception to the *Hertz* holding.

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200. See *supra* note 10.

201. See, e.g., Sawyer, *supra* note 66, at 653; see also Timothy J. Yuncker, *Inactive Corporations and Diversity Jurisdiction Under 28 U.S.C. 1332(c): The Search for a Principal Place of Business*, 28 U. TOL. L. REV. 815, 831 n.103 (1997).

202. *Brewer v. SmithKline Beacham Corp.*, 774 F. Supp. 2d 720, 722 (E.D. Pa. 2011).

As a third option, Congress could clarify a test for holding corporations by statute. The Supreme Court of the United States has explicitly left to Congress the task of “accommodating our diversity jurisdiction to the changing realities of commercial organization” if it sees fit to do so.<sup>203</sup> Because holding corporation business structures are increasing in popularity, Congress should consider crafting a statutory rule for how citizenship is to be determined for holding corporations and other atypical business organizations.

## VI. CONCLUSION

After the Supreme Court of the United States’ decision of *Hertz Corp. v. Friend* in 2010, a corporation’s principal business is its nerve center – its “center of direction, control, and coordination” – without exception.<sup>204</sup> When the nerve center test is applied to a newly-created holding corporation, any conclusion that it is permissible to allow the corporation’s nerve center to be an office where the corporation intends to hold its future board meetings – as suggested by the Ninth Circuit in *3123 SMB LLC* – defies *Hertz* precedent and allows litigants to secure a federal forum based on distant hopes and loose plans. Consequently, a newly-formed holding corporation’s principal place of business will reflect a deceptive center of control rather than the current location of its control functions. This result is inconsistent with 28 U.S.C. § 1332 and the holding and reasoning in *Hertz*.

The dicta provided by the Court in *Hertz* – that mere board meetings are not enough to establish a corporation’s principal place of business – should govern the principal place of business determination for corporations, regardless of the specific type of corporate structure presented. A newly-formed corporation will often have its nerve center in the location where the corporation’s officers and directors are making the decisions necessary to establish and grow the business. Because this approach is consistent with the nerve center test announced in *Hertz* and the desirable policy result of administrative simplicity, the federal courts should apply this approach when determining a holding corporation’s principal place of business, and any notion that carving out a “holding company exception” to *Hertz* is an acceptable method of reconciling any existing inconsistencies between *Hertz*’s “nerve center” test and the nature of holding corporations should be emphatically rejected.

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203. *Johnson v. SmithKline Beecham Corp.*, 724 F.3d 337, 348 (3d Cir. 2013) (citing *Carden v. Arkoma Assocs.*, 494 U.S. 185, 197 (1990)).

204. *Hertz Corp. v. Friend*, 559 U.S. 77, 93 (2010).